

Message Text

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ACTION NEA-10

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SUBJ: US TAX REFORM ACT OF 1976

REF: (A) TEHRAN 12132(NOTAL), (B) ABU DHABI 3277(NOTAL)

1. SUMMARY: REACTION TO THE TAX REFORM ACT OF 1976 HAS BEEN
UNIVERSALLY NEGATIVE AMONG THE NON-GOVERNMENT AMERICANS IN
THIS CONSULAR DISTRICT. HOWEVER, THE EFFECT OF THE ACT, WHILE
CERTAINLY NOT BENEFICIAL TO US BUSINESS INTERESTS HERE, IS
NOT AS CLEAR-CUT IN ITS NEGATIVE IMPACT AS OUTRAGED EXPATRIATES
WOULD HAVE ON BELIEVE. CONGRESS MAY BE WILLING TO RECONSIDER
ITS ACTION, BUT A STRONG CASE FOR TAX EXEMPTION WILL HAVE TO
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BE MADE BY AMERICAN BUSINESS AND, PRESUMABLY, THE NEW ADMINISTRATION.
END SUMMARY.

2. INTEREST IN THE TAX REFORM ACT OF 1976 AMONG NON-GOVERNMENT
MEMBERS OF THE AMERICAN COMMUNITY IN THIS CONSULAR
DISTRICT HAS

BEEN HIGH. COMPLAINTS ABOUT ITS EFFECTS HAVE BEEN UNIVERSAL. THE RECENT VISIT OF THE RIBICOFF-BAKER CODEL AND ITS ATTENDANT MEETING WITH AMERICAN CITIZENS IN SHIRAZ PROMPTED A LARGE TURN-OUT OF ANGRY EXPATRIATES. A NUMBER OF THE SENATORS AND STAFF MEMBERS WERE IMPRESSED BY THE STRENGTH OF THE PROTEST AGAINST THE NEW LAW, AND SEEMED OPEN TO RECONSIDERATION OF ITS EFFECTS ON AMERICAN BUSINESS ABROAD. UNFORTUNATELY, THE ISSUE IS A COMPLEX ONE NOT READILY SUSCEPTIBLE TO A SIMPLE ANALYSIS IN BLACK AND WHITE.

3. FIRST, THE NEW LAW DOES NOT AFFECT INDIVIDUALS IN EXACTLY THE SAME MANNER. A SIGNIFICANT NUMBER OF THE AMERICANS IN THIS PART OF IRAN WORK FOR COMPANIES WITH TAX EQUALIZATION OR SIMILAR SUCH PROGRAMS. WHILE THE PROFIT MARGINS OF THE COMPANIES MAY OR MAY NOT BE REDUCED (DEPENDING ON THE NATURE OF THE CONTRACT THEY HAVE WITH THE IRANIAN GOVERNMENT OR OTHER LOCAL ENTITY), THE AFTER-TAX INCOMES OF EMPLOYEES DERIVED FROM SALARIES REMAIN THE SAME. THE ONLY EFFECT OF THE LAW ON THESE INDIVIDUALS IS THE RATE AT WHICH THEIR OUTSIDE INCOMES ARE NOW TAXED.

4. SIMILARLY, THE LAW AFFECTS DIFFERENT COMPANIES IN DIFFERENT WAYS. FOR THOSE OPERATIONS WITH COST-PLUS CONTRACTS, THE ADDED COST OF THE TAX CAN BE PASSED ON TO THE CONTRACTING PARTY, FREQUENTLY THE IRANIAN GOVERNMENT. IN SOME AREAS, WHERE NON-AMERICAN COMPETITORS EXIST, US FIRMS MAY FIND THEMSELVES DRIVEN OUT OF THE MARKET. IN OTHERS, HOWEVER, WHERE IRAN SEEMS PREPARED TO PAY ALMOST ANY PRICE FOR SUPERIOR AMERICAN TECHNOLOGY (E.G., CERTAIN UNCLASSIFIED

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SOPHISTICATED WEAPONS SYSTEMS), WE ARE IN EFFECT THE SOLE SUPPLIER.

5. THE NEW LAW UNDOUBTEDLY IS GOING TO HAVE AN ADVERSE IMPACT ON AMERICAN BUSINESS OPERATIONS AND OPPORTUNITIES HERE. THE ONLY QUESTION IS HOW SEVERE IT WILL BE. IN SOME FIELDS, SUCH AS THE HIGHLY COMPETITIVE CONSTRUCTION INDUSTRY, AMERICAN FIRMS, ALREADY FIGHTING TO MAINTAIN MINIMAL SHARE OF THE MARKET, WILL QUITE PROBABLY BE PUSHED OUT COMPLETELY. IN THE OIL INDUSTRY, HIGHLY SKILLED BLUE COLLAR WORKERS MAY HAVE TO CHOOSE BETWEEN REDUCED EARNINGS IN IRAN AND THE PROSPECT OF UNEMPLOYMENT AT HOME. EXECUTIVE AND PROFESSIONAL LEVEL PERSONNEL IN THE SAME INDUSTRY MAY HAVE JOBS TO GO BACK TO WITH THEIR PARENT COMPANIES, BUT THEIR ABSENCE COULD MEAN REDUCED PURCHASES OF AMERICAN-PRODUCED EQUIPMENT. AS POINTED OUT IN PARAGRAPH 4 OF REFERENCE B, PEOPLE PREFER PRODUCTS THEY KNOW, AND BRITISH, FRENCH AND ITALIAN EXECUTIVES AND ENGINEERS ARE NOT LIKELY TO BUY

AMERICAN. SOME COMPANIES, SUCH AS THOSE AFFILIATED WITH IRAN ELECTRONICS INDUSTRY HERE IN SHIRAZ, WILL MOST LIKELY SURVIVE BUT WITH REDUCED PROFIT MARGINS.

6. CONGRESS MAY BE WILLING TO RECONSIDER WHAT IT HAS WROUGHT, BUT AMERICAN BUSINESS AND, PRESUMABLY, THE NEW ADMINISTRATION WILL HAVE TO MAKE A CONVINCING CASE THAT THE LAW INDEED ADVERSELY AFFECTS THE HEALTH OF THE ECONOMY. IF AMERICAN EXPATRIATE BUSINESSMEN AND WORKERS ARE TO BE GIVEN PREFERENTIAL TAX TREATMENT, THEY WILL HAVE TO SHOW THAT THE REVENUE LOST BY THE TREASURY IS MORE THAN OFFSET BY BUSINESS GENERATED FOR DOMESTIC FIRMS AND INCREASED TAXES PAID BY THEM AND THEIR EMPLOYEES. PERHAPS MOST IMPORTANT OF ALL, ECONOMIC JUSTIFICATION OF TAX EXEMPTION WILL HAVE TO OUTWEIGH THE POLITICAL POPULARITY OF CLOSING A LOOPHOLE WHICH MANY IN CONGRESS APPARENTLY BELIEVED IS REGARDED BY THE MAJORITY OF THE ELECTORATE AS UNFAIR.

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